

BUSINESS ISSUES BULLETIN

Translated from original Vietnamese document

VIETNAM

THE BUSINESS INFORMATION CENTER AT THE VIETNAM CHAMBER OF COMMERCE AND INDUSTRY

No.23 (26) March 2008

PROVINCIAL ECONOMIC GOVERNANCE AND ITS IMPACT ON LOCAL COMPETITIVENESS

Three years have passed since the debut of the Provincial Competitiveness Index (PCI). Created by the Vietnam Chamber of Commerce and Industry and the Vietnam Competitiveness Initiative (VNCI), the Index has had a compelling impact on provincial government agendas and, consequently, the prioritization of private sector development.¹ Positive developments include a number of provinces conducting a thorough review of their economic governance and kicking off a range of business environment reforms. Consequently, the country has seen widespread simplification of business-related administrative procedures and a reduction in the number of required business licenses in order to encourage business entry and investment.

Last year, however, results showed a growing imbalance in economic development, as those provinces characterized by weak governance and/or unfavorable conditions fell further behind the top performing provinces (see table below). As Vietnam pushes forward with its decentralization process, local authorities have been granted more autonomy and responsibility for directing economic development within their jurisdictions. This is prompting the Central government to more closely scrutinize annual provincial performance in order to better allocate budget resources.

Province	Top/Bottom 2006 GDP per capita Provincial Performance (VND million)	PCI Ranking
Dong Nai	9.9	Excellent
Binh Duong	9.6	High
Da Nang	8.8	High
Dien Bien	2.8	Low
Bac Can	2.6	Mid-low
Lai Chau	2.1	Low

Increased transparency in administrative regulations and procedures will save firms time and money

Provincial business environments are still plagued by a strong presence of informal charges. According to PCI 2007, in one mid-ranking province, 70% of firms surveyed complained that their line of business was subject to bribes, while 12% admitted to paying over 10% of annual revenue for informal charges, and 39% believed that government officials usually take

advantage of local administrative regulations for personal profit. Informal charges are so common that only 30% of firms view it as an obstacle to their business (it remains to be seen whether the remaining two-thirds accept it as a standard business procedure) and nearly 50% of firms admit that paying informal charges helps deliver intended results.

In such an opaque business regulatory environment, it is difficult for entrepreneurs to make strategic decisions on investment as they lack the ability to accurately assess the associated

costs and risks. Better and easier access for firms to legal and regulatory information, along with transparent administrative procedures should greatly diminish the current need for personal relationships in dealing with provincial authorities. When implemented properly, these measures should go a long way towards eliminating the practice of informal charges.

Development of private sector greatly affected by dynamism of provincial personnel

A VNCI study on Vietnam's decentralization process illustrated that the capacity and dynamism of the provincial authority directly facilitates development of the local business sector and social welfare. Greater autonomy for provincial authorities on budget allocation and approval of investment projects within their province directly benefits private sector where provincial staff is proactive and highly capable.² Conversely, provinces hampered by weak governance are not able to make significant progress in the face of
(Continued in page 4)



This bulletin is published with support from the Mekong Private Sector Development Facility (MPDF), a multi-donor funded initiative managed by the International Finance Corporation (IFC), the private-sector arm of the World Bank Group.

The "Business Issues Bulletin" provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Vietnam, and exposure to different opinions held by various stakeholders on the topic.

The statements and opinions presented here are only meant to provide additional reference material and do not reflect official opinion of the Vietnam Chamber of Commerce and Industry (VCCI) or the Mekong Private Sector Development Facility (MPDF)/IFC.

Readers are welcome to copy and distribute the information contained in this bulletin provided acknowledgement is given to VCCI/MPDF as the source.

(1) The PCI measures the repercussions of regional leadership on the business climate and economic performance. It then compares provincial results across the country, taking into account the effects of structural endowments and conditions, such as market size, human and physical capital stocks, infrastructure, and location.

(2) Excepting those projects under central government authority, due to size and/or special conditions

Increased transparency in administrative regulations and procedures will save firms time and money



- In theory, firms are afraid to declare the full extent of their activities in poorly governed areas because they worry that official knowledge of the size of their business will raise the cost of informal charges and transaction costs that they face. The PCI data gave us an opportunity to explore this in depth. We studied formalization in aggregate, by

looking at the percentage of private, industrial activity accounted for by the formal private sector. We followed this with a firm-level study of how long individual household firms remained informal before registration. In both studies, it is clear that economic governance is positively correlated with the decision of firms to formalize their activities by registering at Departments of Planning and Investment. For firms established 15 years or more, good governance reduces the time they spent as household firms by over 10 years. As you might expect, entry costs, land access, proactively, and legal institutions were the main factors most closely associated with decision to formalize.

*Mr. Edmund J. Malesky, Associate Professor
Graduate School of International Relations and Pacific Studies, University of California, San Diego & Consultant to PCI*



- In my opinion, improving transparency and reducing informal costs can be achieved if there is a clear information-sharing mechanism that spans the provincial agencies. In our province, a number of mechanisms have been implemented - such as single access point for investment

licensing, single access point for business registration, and a web-based business information gateway.³ We are currently developing a mechanism [back office function of this portal] for relevant agencies to enter and share information, which will be key for increasing business access to information on legal and administrative procedures.

We realized that it is difficult for enterprises to catch up and conform to new regulations and business conditions because of the huge number of documents issued and stipulated by the various state organizations. At the same time, it is extremely time consuming for local government staff to answer all business inquiries. In many cases there are delays as the local staff needs to consult with central agencies. In setting up the portal, each local government agency is responsible for providing and updating its own legal documents, regulations, and business conditions through one information gateway.

Enterprises will no longer need to go around collecting all the legal documents, nor will they need to work with the many different state agents on separate procedures. We expect that this initiative will have the dual benefit of saving time and costs for enterprises, and will simultaneously minimize the number of interruptions officials are regularly subjected to. We also hope that this model will be applied at the central level. For example, the MPI could issue an annual handbook with guidelines for all licenses and business requirements stipulated by ministries and state departments. This would go a long way towards efficiently providing enterprises with the necessary information on laws and regulations for the operation of their businesses.

*Mr. Doan Ngoc Minh
Manager of Enterprise Management Division
Investment and Planning Department, Quang Nam Province*



- Although Binh Dinh is one of the top performing provinces in the PCI, our leaders are aware of weaknesses and constraints that remain in the business environment - including poor infrastructure conditions and a large labor force that lacks training and necessary skill sets. For sustainable

economic development, provincial leaders have been proactive in establishing initiatives that attract investment resources to the province. The provincial authority has issued a list of projects calling for investment, and provided clear incentive policies on labor, trade promotion, and/or land allocation in industrial zones. More importantly, the province has focused on providing the private sector with information on investment policies and procedures to improve transparency through public media and the provincial website. A number of simplification projects on administrative procedures have been also been implemented, such as business registration, construction licensing, and land allocation. Our provincial leaders are taking steps to stipulate in detail the responsibilities of each department and its personnel, in order to shorten the approval process for investment projects and improve the attitude and manner of the officers serving the business sector. All of these actions are being done in order to create a level playing field for all business sectors in the province and to help contribute to provincial revenue.

*Mr. Nguyen Thanh Hai
Director of Investment Promotion Center
Department of Investment and Planning, Binh Dinh Province*

(3) See www.quangnambusiness.gov.vn

Development of private sector greatly affected by dynamism of provincial personnel



● The PCI research team for the past several years has observed an interesting perspective on reform incentives and policy implications in a number of provinces. As you know, Vietnam has divided some of the larger provinces into two smaller ones. These divisions often resulted in one less developed, agricultural-based province without any large SOEs, and one with most of the industrial base and infrastructure investment. Of the two, it has generally been the lesser developed provinces that have shown a stronger initiative towards reform, attracting investment, and developing a strong private business sector. The absence of large SOEs has somehow been an advantage for these provinces, as they have been less encumbered in their push for private sector development. In addition, the competitive incentive to catch up to and pass those better off provinces has made provincial authorities more proactive towards reform and local economic development. As a result, some of the “poorer” provinces are changing faster than their better-off former ‘mates’.

For example, Quang Ngai and Binh Dinh were divided out of the former Nghia Binh province. Quang Ngai has been favored by the Central Government, in terms of large investments in the Dung Quat Industrial Zone. Binh Dinh, on the other hand, received less and chose to actively develop a local SME sector. At present, Binh Dinh is one of the top-ranked provinces (4th in PCI 2007), while Quang Ngai has achieved a much lower ranking (45th in PCI 2007).

*Mr. Dau Anh Tuan, Legal Department
VCCI*



● Recently, the autonomy of local authorities has increased in the areas of fiscal administration (Budget Law 2002, effective in 2004), and approval of investment projects in their respective jurisdictions (Common Investment Law 2005). However, there still are areas where Vietnam's legal system is relatively unclear, unstable, and rapidly evolving. These areas can make it difficult for authorities to effectively exercise their autonomy. In such cases, progress depends on local leadership. For example, there are many issues with the approval of potential investment projects that the Investment

Law does not adequately address. In such situations, the local authorities have to first get official instruction from related ministries. This process can take a lot of time. At the same time, they are under pressure to approve licenses for the investors by the deadline stated in the Law.

In some provinces, local authorities are not waiting for official implementation guidelines and instruction. In other provinces, local authorities wait passively for instruction. So it is the initiative and capability of the local authorities that makes the difference. This point raises a sensitive issue related to the autonomy of provinces in personnel arrangement. Ultimately, to achieve growth objectives and development strategy, the provincial authorities need to be able to make independent decisions on the quality of their personnel.

*Mr. Vu Thanh Tu Anh
Fulbright Economics Teaching Program*



● After three years of continuous, commune to provincial level reforms, Ha Tay province has learned some important lessons. First, reforms to improve the business environment are long-term projects and require total effort from the government departments, political leadership and the local business sector. Second, information dissemination is important for the government and the business sector to understand the problems and constraints of the business environment. Third, reforms need to face the sensitive problem of personnel - including penalizing and replacing corrupt and incapable officials when necessary.

An illustration of a successful Ha Tay province initiative was its improvement on the “land issue”. For several years, Ha Tay had a poor reputation with its land recovery process. In order to reform its land allocation procedures, the province implemented a comprehensive information campaign that helped business and landholders better understand the provincial land use policy and transition plan. In addition, corrupt officers were fined and their departments were strengthened in order to regain the faith of the business sector. Thanks to these measures, Ha Tay's “land issue” reputation gradually improved, and now contributes to the province's better business environment.

*Mr. Nguyen Van Tu, Vice Director
Department of Investment and Planning
Ha Tay Province*

Quality of local labor force affecting provincial investment



● The number of trained workers is increasing significantly. The country's objective is for 26% of the total workforce to be trained workers by 2010. However, this figure is admittedly low in comparison with other countries in the region, which average around 50-60%. In fact, the lack of trained personnel is weakening our country's competitiveness. And

while occupational training has been developing, it is on too small a scale to meet actual demand.

Constraints stem from two main causes. First is the need for large investment for training facilities. The present government allocation cannot cover further expansion of the vocational training system. Second is that the training system (and the education system in general), is still supply driven. Training centers and schools are providing outdated training programs instead of what of the market truly needs. As a result, the structure of training system is imbalanced, and there is a surplus in some professional areas, and a deficit in others.

Additionally, readily available information on labor demand suffers from a lack of labor information centers that could help to survey and publish requirements for given professional jobs and skills needed. These information systems are not receiving the necessary attention from the provinces. For example, on an investment project, the investor and the local authority always focus their attention on capital amounts and land area, but they are unable to calculate the number of workers with particular skill sets needed. Some provinces with high concentration of industrial zones have policies to attract highly skilled labor from other localities, but have yet to develop a highly skilled local workforce. This leads to problems, as we saw in the case of Binh Duong.

Binh Duong has a comparatively large number of industrial zones and attracts a substantial labor force from less developed provinces. But as the industrialization process begins to spread

to these poorer provinces, the workers are moving back to their hometowns to fill the available jobs, and Binh Duong is having a hard time filling positions.

Dong Nai has similar economic conditions to Binh Duong. It on the other hand does not have the same labor problem because proper measures have been taken to train the local workforce. Currently, Hanoi, Ho Chi Minh City, Vinh Phuc, Hai Duong, and other provinces with a high demand for labor from many concentrated industrial zones, local authorities have realized that the local workforce will play a vital role in attracting investment projects. These authorities are taking the first steps to turn their local training mechanisms into demand-driven ones.

*Dr. Duong Duc Lan, Standing Deputy Director General
General Department of Vocational Training, MOLISA*

● Labor will be a hot issue for the business environment in a number of provinces in the near future. Poor provinces are lacking resources for local vocational training, and this in turn is a constraint for investment. In more developed provinces, the workforces are mainly trained by enterprises for their own specific needs. Presently, the provincial budget for vocational training comes from the central government. The distribution of the training budget is fixed and never efficiently takes into account the impact of large labor flows among the provinces.

As we have seen, the more developed, metropolitan provinces are able to attract cheap labor from neighboring provinces. So it is suggested that the poorer and peripheral provinces should be prepared to serve the labor needs of potential investment projects in the more developed provinces by designing a suitable training plan for their own, local workforce. It also means they will be in a position to take on future projects themselves. In short, the preparation of a highly skilled workforce will help improve the chances for greater investment and a better business environment in both developed and peripheral provinces.

*Mr. Dau Anh Tuan, Legal Department
VCCI*

(Continued from page 1)

Vietnam's currently fluctuating business regulatory environment. This then translates to frequent investment procedure delays and slower business development.

The 2007 PCI showed that greater levels of local private sector development are met by greater demand from the business sector to further improve the quality of local governance. For example, Binh Duong province, despite maintaining the PCI's top performance ranking, failed to receive high marks from its business community, who responded that efforts from local officials have not improved over previous years.

Quality of local labor force affecting provincial investment

Creation of a skilled labor force trails only land allocation in terms of urgency for future local economic development.

According to the 2007 PCI, nearly half of all businesses surveyed were unsatisfied with the quality of vocational training and other supporting labor services. Firms indicated that vocational training schools and centers are state-owned and apply obsolete curricula, which often do not offer courses in line with practical demands of the business community. These schools have neither the budget nor the incentive to upgrade services. Private firms (most of whom are small businesses) simply do not have the resources to train their employees. And even when firms invest in training, they do so at the risk of having their employees poached by other businesses - particularly by those located in provinces close to major cities. Developing a market for quality vocational training and labor matching services is critical for attracting more investment.